High Impact Tax Strategies

for Affluent Individuals and Families

OSBORNE PARTNERS

Who wouldn't want to pay the lowest lifetime tax bill? This is a goal we regularly discuss and aim to achieve for our clients.

We spend a lot of time studying (and keeping up to date with) the U.S. tax code and potentially advantageous strategies. Given that "the tax law is written in pencil" (constantly changing), long-term tax planning and optimization is a particularly complex subject with multiple variables and unknowns to consider.

At Osborne Partners, we believe there are a number of potentially high impact tax strategies that are worth evaluating now. Some of these strategies will be optimally implemented during low-income years. Other strategies are better suited for high-income years. But thoughtfully implemented, these strategies can better position investors to achieve the goal of "paying their lowest lifetime tax bill".

This piece discusses three of the most impactful strategies we often evaluate with our clients.

1. Tax Advantage of "Tax Valley" Years

Intuitively, it can feel like a victory to pay zero dollars in income taxes in any given year. However, given the goal of paying the lowest *lifetime* tax bill, a low tax year can often be a horrible thing to waste.

Let's assume you are starting a company (with little forecasted revenue in early years), taking a sabbatical, or just entering retirement. In instances like this, your income is likely projected to be substantially lower now than in the future. We call these the "tax valley" years. You may be surprised to know that this is an optimal period for implementing certain tax strategies.

Given the number of potential strategies that are worthy of evaluating during a tax valley, we've developed and refined a "tax strategy order of operations" to help clients make the most optimal tax strategy decisions. While certain variables, individual financial positions, goals, etc. can impact the specifics, below are brief introductions to the most impactful strategies during low-income years:

Roth Conversions:

- Roth IRA accounts provide the benefits of tax-free accumulation and, once you reach retirement age, tax-free distributions. This is why many taxpayers convert their Traditional IRA account to a Roth IRA.
- However, to do so, you must generally pay tax on the converted amount. Many taxpayers overlook the most opportune times to make conversions, such as in low-income years, when marginal income tax rates (and the amount you pay in taxes) are relatively low.
- Please see https://osbornepartners.com/smart-things-for-investors-to-do-during-periods-of-volatility/ for more detail on the subject.

Tax GAIN Harvesting:

- While tax-loss harvesting can be popular during a stock market downturn, tax-*gain* harvesting — or strategically selling appreciated brokerage account assets — can also be advantageous during a low-income year. Tax-gain harvesting is appropriate for investors who fall into the 0% capital gains bracket.
- For 2024 you can qualify for the 0% rate with taxable income of $47,025 or less for single filers and $94,050 or less for married couples filing jointly. The primary advantage of tax-gain harvesting in the 0% bracket is the ability to increase an asset's purchase price, or "basis," which can reduce future taxes. Essentially, you can sell an asset and immediately repurchase it to reset the basis to the new higher price, and it's not costing you anything.

Larger Distributions from Inherited and Traditional IRAs

- We often talk about "controlling your income" and "filling your income tax bracket" as a key element of any tax strategy. Controlling your income is critical, as your income not only determines your tax bracket, it also can drive the price of Medicare insurance, trigger other taxes such as the Net Investment Income Tax, etc.
- A low-income year is an opportune time to take larger distributions from your Traditional IRA or Inherited IRA, as you will likely be in a lower income tax bracket now than in the future (when you would pay more taxes on the distributions). However, when determining the optimal amount to withdraw from your IRA accounts, it is critical to control your income (distributions are included in taxable income) and plan around other tax triggers, such as additional Medicare premiums or to avoid Net Investment Income taxes.

Exercise Stock Options

- If you are an employee and exercise non-qualified stock options, you must report the difference between your preferential option (grant) price and the stock's value when you exercise the option as income. This income will be included in your wages on your year-end W-2 form. In a low-income year, this is the optimal time to exercise some or all of your options, without any, or with minimal, income tax liability.

Delay Personal Tax Deductions

- If you itemize your deductions and they provide no or minimal tax benefit this year, you might consider delaying paying that elective medical expense, real property tax bill, or making a sizeable charitable contribution, until the future, when you would recognize a larger tax benefit.
- Many taxpayers find it beneficial to "bunch" deductions in one year and then claim the standard deduction in the alternate year. More on this strategy to come.

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2. Evaluate Trust Vehicles During High Income Years to Maximize Tax Efficiency

With likely changes to the tax code set to take place at the end of 2025 (e.g., reduction in the Estate Tax exemption amount, changes to how assets are handled and taxed within certain trusts), now is a particularly advantageous time for affluent families and individuals to consider these trusts as a way to maximize tax efficiency and achieve a number of other goals.

Today, we are going to focus on just one impactful type of trust, a Charitable Remainder Trust ("CRT"). This is effectively a gift of cash or other property (such as appreciated stock or real estate) to an irrevocable trust. Quite contrary to the previous section, where we evaluated strategies during *low*-income years, a CRT is particularly powerful during a *high*-income year.

There are multiple benefits to the donor of a CRT:

- The donor receives an income stream from the trust for a term of years or for life.
- With the gift of appreciated stock or property, the donor defers the capital gains which would have been generated by selling the property/stock.
- The donor receives an immediate income tax charitable deduction when the CRT is funded based on the present value of the assets that will eventually go to the named charity.
- The named charity receives the remaining trust assets at the end of the trust term.

There are a few reasons why now is a good time to evaluate a CRT:

- The stock market and real estate market have appreciated significantly in value over the last year and are near all-time highs.
- By gifting appreciated property/stock to the CRT, you defer the recognition of capital gains over the life of the trust. Capital gains are recognized when funds are distributed from the trust.
- One of the benefits of a CRT, particularly for affluent families in a high-income year, is that the donor gets an immediate tax deduction for the present value of the assets that will eventually go to the charity.
- Tax deductions are most impactful during high-income years, when marginal income tax brackets are at their highest.

There are multiple other trusts worthy of evaluating for high income individuals, or families with significant wealth, such as a Grantor Retained Annuity Trusts. For a more in depth look at these vehicles and trusts, please see https://osbornepartners.com/three-powerful-tax-strategies-to-evaluate-now

3. “Bunching” Strategy & Alternating Between Standard and Itemized Deductions

Writing a check to your favorite charity or gifting highly appreciated stock is often a great way to potentially reduce your tax liability.

However, a challenge here for roughly 90% of Americans, is that they may not recognize a tax benefit from a charitable deduction. Or a taxpayer may not benefit from the write-off of a material medical expense. The reason being is that 90% of Americans utilize the standard (not itemized) tax deduction, and you do not receive a tax benefit for these deductions when using the standard deduction.

Given this, we often evaluate the strategy of “bunching deductions” for clients. This is a tactical tax planning technique where a taxpayer strategically alternates between bunching (and itemizing deductions), then claiming the standard deduction in different years with the goal of maximizing long-term tax savings.

For high income families and individuals, instead of spreading out deductible expenses evenly over multiple years (e.g., charitable gifts), it can be advantageous to "bunch" or concentrate these expenses into a specific year and exceed the standard deduction threshold. As a result, this generates a larger tax savings in the bunched (itemized) tax year. This approach is particularly effective for high-income families with expenses that can vary from year to year, such as medical expenses, or charitable contributions.

For example, instead of making smaller, annual charitable gifts, we could recommend every third year a donor contributes to a Donor Advised Fund (“DAF”) with an amount equal to the total charitable goal for three years. In the year of the contribution, the donor itemizes their deductions (instead of a standard deduction) when filing their tax return. In the next two years, the donor makes their grants to qualified charities from the DAF and claims the standard deduction on the tax returns. This compares to making numerous smaller contributions and taking the standard deduction where the taxpayer does not get a tax benefit of a charitable contribution.

During the “itemized” year, a client would also be well served by pulling forward other itemized expenses, such as elective medical expenses, to maximize the tax benefit.

At Osborne Partners, we are passionate about helping affluent families and individuals evaluate various tax strategies and optimize their long-term tax picture. These are often complex decisions and projections with many variables to evaluate. Please reach out to your Wealth Counselor and/or accountant to have a thoughtful discussion around all potential tax considerations to help you make the most optimal decisions.

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